6/8/88

B53502

MANUFACTURERS HANOVER

Financial Digest

Volume XXV, Number 12

Monday, June 6, 1988

Analysis of Business Trends Plus Selected Financial Indicators

The Dollar Rebounds

While the bond market wrestles with the question of whether or not the Federal Reserve is in the midst of a progressive tightening of monetary policy, the foreign exchange market is debating a closely related question, namely, if interest rates are headed higher, what is the dollar's upside potential? For with the economy exhibiting a fair degree of forward momentum, the trade deficit narrowing and the central bank stepping on the money and credit brakes (Financial Digest–May 23, 1988), some analysts believe that the dollar is poised for a good-sized, upward move–convincingly breaking out of the narrow trading ranges within which it has fluctuated all year long.

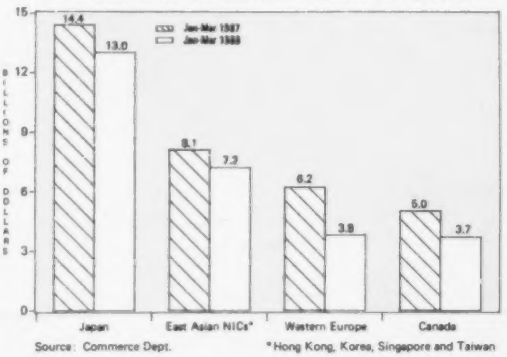
Expectations of a higher-valued dollar would have been unthinkable in the absence of a dramatic narrowing of the trade deficit–an improvement which has only recently become "visible". For although export volumes have been rising at double-digit rates for over a year now, and the growth of non-petroleum import volumes has been slowing, improvements in the real trade balance have been masked by a rapid run-up in import prices. This was largely due to the dollar's ongoing depreciation over the past three years, which boosted import costs at a much faster clip than the actual growth of import volumes. Not surprisingly, with the widely-followed, current dollar trade deficit mired in red ink, foreign exchange market participants remained skeptical that the U.S. trade picture was brightening and that the dollar's slide was over.

A good chunk of the prevailing skepticism evaporated, however, in the wake of the March trade balance numbers. Reflecting a torrid 23 percent month-over-month surge in exports, to a record $29 billion, the trade deficit tumbled from nearly $14 billion in February to less than $10 billion in March, marking the first time that the trade deficit was in single-digit territory in three years. As if on cue, market psychology began to shift–and the dollar started to move higher.

The Trade Deficit On The Mend

The dollar's ascent has not been uniform, reflecting the uneven progress that has been made in reducing our regional, and country-specific trade imbalances. Whereas the dollar has scored its most sizable gains against the European currencies in recent days, where the trade gains have been most pronounced, it has edged only slightly higher against the Japanese yen.

U.S. TRADE DEFICIT WITH SELECTED AREAS: JANUARY-MARCH 1988 VS. JANUARY-MARCH 1987



Source: Commerce Dept. *Hong Kong, Korea, Singapore and Taiwan

Take, for example, the trade balance with Western Europe. Although a sizable deficit with West Germany still persists, our trade woes here are no longer regional in nature; if the red ink with Germany is excluded from the European totals, the U.S. trade balance with the rest of the region moved solidly into the black in March for the first time since late 1983. On the other hand, the stubbornly large trade deficit with Japan has seemingly put a lid on the dollar's upside potential against the yen, while large deficit totals with such East Asian countries as Taiwan and Korea makes it a good bet that further dollar depreciation against the currencies of these two countries will be necessary if the current trade imbalances are to be reduced (see chart).

At the same time that the dollar was being bolstered by a narrower trade deficit, reports of a stronger-than-expected economy in the first quarter, a subsequent firming of Fed monetary policy and an upturn of short-term interest rates enabled the "greenback" to extend its trade-related gains. According to the Commerce Department, the economy grew at a much faster clip in the first quarter

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than had been initially reported. Real GNP is now estimated to have expanded at a 3.9 percent annual rate in the January-March quarter, a far more vigorous advance than the original estimate of a 2.3 percent rate of rise.

Since this comes on top of reports of surging industrial commodity prices, rising operating rates in most industries and diminished unemployment, expectations of additional Fed tightening moves mounted–sending interest rates higher, and enhancing the relative attractiveness of the dollar even further. As a result, the dollar did break higher early last week, hitting a seven-month high against the Deutschemark.

Economic Conditions Lend Support

It would be a mistake, however, to attribute too much of the dollar's current rebound to the robustness of the economy and the likelihood of anoher turn of the monetary screws. Because if it was, the dollar would probably soon be heading south again, since neither the economy is as strong, nor monetary restraint as imminent as many of the pundits seem to think.

For one thing, business activity in the current quarter appears decidedly less robust

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits of $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/18/88)	182,107	+ 431	+ 8,821
New York City (5/25/88)	38,170	+ 336	+ 881
Commercial Paper			
(5/25/88)	412,651	– 937	+ 54,641

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/18/88)	299,954	– 1,018	+ 6,927
New York City (5/25/88)	57,357	+ 87	– 4,915

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (5/18/88)	884,924	– 631	+31,926
New York City (5/25/88)	172,409	– 2,071	–36,975

Financial Markets

	Friday 6/3/88	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	6.67%	– .01	+ .84
180-Day Bills†	7.05	– .11	+ .79
Longest Bills†	7.51	– .09	+ .64
Recent Issues:			
8⅛s 5/31/90	8.00	– .19	
7⅞s 3/31/92	8.39	– .21	
9s 5/15/98	8.99	– .24	
9⅛s 5/15/18	9.09	– .24	
Municipals:			
Bond Buyer–20 Bond Index* (6/2/88)	7.87%	– .09	– .10
Blue List Total ($ Million)	$1,330	+ $ 2	– $ 47
30-Day Visible Supply ($ Million)	$2,453	– $403	+ $253
Total	$3,783	– $401	+ $206
Corporates:			
Moody's Aa Composite (6/2/88)	10.25%	+ .05	+ .46
30-Day Visible Supply ($ Million)	$4,327	+ $245	– $856
Stocks:			
Dow-Jones Averages:			
Industrials	2,071.30	+ 114.86	–254.85
Transportation	853.94	+ 49.28	–132.72
Utilities	178.34	+ 7.47	– 20.30
65 Stocks	771.12	+ 41.71	–102.39
N.Y.S.E. Composite Index	150.31	+ 6.65	– 15.18
N.Y.S.E. Avg. Daily Vol. for Week (000's)	216,990	+ 80,908	+69,553

*34% Taxable equivalent 11.92%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 6/3/88	Week Ago
Overnight	7.13%	7.38%
1 month	7.50	7.50
3 month	7.63	7.63
6 month	7.81	7.88
1 year	8.19	8.38

FOREIGN EXCHANGE SPOT RATES

New York Opening (6/3/88)	Currency Per U.S. $	Week Ago
Belgium	36.06	35.76
Canada	1.2300	1.2390
France	5.8400	5.7780
Germany	1.7240	1.7135
Italy	1282.25	1270.50
Japan	125.84	124.74
Mexico	2273.00	2273.00
Netherlands	1.9370	1.9190
South Korea	733.20	732.80
Switzerland	1.4362	1.4305
Taiwan	28.62	28.62
U.K.*	1.7985	1.8586

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (6/3/88) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.6%	–6.3%

than it was in the first, as evidenced by the flattening of personal consumption expenditures in April and the lethargic advance of the index of leading economic indicators in the same month. For another, it is hardly a foregone conclusion that a further tightening of monetary policy is just around the corner, especially if the economy's growth is indeed slowing. Rather than higher interest rates ahead, the latest batch of economic statistics might have brightened the prospects for stable, if not lower interest rates.

But this turn of events does not necessarily mean that the dollar will give back its recent gains. In fact, quite the opposite, since lower interest rates, if accompanied by a softer economy, could work strongly in the dollar's favor. This is because a generalized spending slowdown would quickly spill over into diminished import purchases, hastening the improvement in the trade balance, and further buoying the dollar. Indeed, whether or not the economy strengthens or weakens, it looks like the dollar will remain firm, if not move somewhat higher in coming months, adding credence to the belief that the dollar touched bottom late last year. How high the dollar can go will depend upon the pace of progress on the trade front. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 6/1/88	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	229.783	+ 3.173	+15.471
Loans to Depository Inst.	3.329	+ .418	+ 2.569
Float	.518	− .241	− .410
Total Reserve Bank Credit	247.803	+ 3.391	+16.776
Treasury Deposits with Federal Reserve Banks	3.210	+ .034	− 1.857
Currency in Circulation	232.125	+ 1.646	+18.366
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	231.066	+ .718	+48.571
	6/1/88		
Member Bank Reserves:			
Total Reserves Held	57.845	− .804	+ .971
Excess (Deficiency)	1.229	+ .331	+ .095
Net Free Reserves	.647	+ .126	+ .310
		‡ % Change Since 3 Months Ago*	‡ % Change Since Year Ago
Monetary Aggregates †			
M1 (5/23/88)	769.3	+ 4.7	+ 3.2
M2 (5/23/88)	3,008.9	+ 7.5	+ 5.4
M3 (5/23/88)	3,782.0	+ 6.5	+ 6.0
Domestic Nonfinancial Debt (4th Q'87)	8,361.5	+ 10.2	+ 10.0

† Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

Offering Rates 6/3/88	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	6.50%	6.78%	7.08%
* Federal Agencies	7.20	7.35	7.45
* Municipal Notes—High Grade (34% Taxable Equivalent)	7.20	7.20	7.58
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	7.50	7.65	8.10

‡ Finance Company Paper—Prime

5- 14 days	7.00%
15- 29 days	7.20
30- 59 days	7.35
60- 89 days	7.35
90-179 days	7.35
180-239 days	7.20
240-270 days	7.20

‡ Industrial Paper—Prime

30- 89 days	7.34%
90-120 days	7.43

‡* Bankers' Acceptances

Jul.	7.30%
Aug.	7.33
Sep.	7.35
Oct.	7.40
Nov.	7.40
Dec.	7.40

† Federal Funds Effective Rate 7.35%

‡ Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	1st Q'88	$ 4,669r	$ 4,607	$ 4,378
Gross National Product (1982 Dollars)*	1st Q'88	$ 3,918r	$ 3,881	$ 3,772
Percent Change, Annual Rate	1st Q'88	3.9r	4.8	4.4
Change in Consumer Prices*	Apr '88	4.8%	6.0%	4.8%
Change in MH Cost of Living Index	Apr '88	9.6%	8.4%	7.2%
Change in Producer Prices*	Apr '88	4.8%	7.2%	7.2%
Civilian Employment (Thousands of Persons)†	May '88n	114,195	114,713	112,334
Unemployment as % of Civilian Labor Force†	May '88n	5.6%	5.4%	6.3%
Personal Income*	Apr '88n	$ 3,944	$ 3,939r	$ 3,702
Leading Indicators Composite Index (1967=100)†	Apr '88n	192.2	191.9r	187.6
Industrial Production Index (1977=100) †	Apr '88	135.6	134.7	127.4
Net Change in Consumer Installment Credit †	Mar '88	$ 4.46	$ 5.04	$ 1.84
U.S. Merchandise Trade Balance	Mar '88	−$ 9.75	−$ 13.83	−$ 12.92
Plant and Equipment Expenditures*	2nd Q'88	$427.09(a)	$422.75(a)	$377.65
Private Housing Starts (Thousands of Units)*	Apr '88	1,561	1,554	1,635
New Construction Expenditures*	Apr '88n	$ 401.8	$ 401.2r	$ 396.2
Total Business Inventories †	Mar '88	$ 720.0	$ 717.9	$ 668.7
Total Business Sales †	Mar '88	$ 479.5	$ 470.7	$ 444.2

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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Commitment

Great Cause, Great Golf!

The Manufacturers Hanover Westchester Classic® presented by NYNEX Westchester Country Club Harrison, N.Y.

June 6-12, 1988

Last year, the Manufacturers Hanover Westchester Classic raised $2 million, becoming the first PGA Tour event to reach this figure. During the last 22 years, this event has raised over $12 million for the 16 area hospitals. This is a special tribute to all the volunteers, fans and corporations who continually support this great charitable event.

This year, Greg Norman, Seve Ballesteros and other top pros from the PGA Tour will compete for $700,000 in prize money.

Tickets are on sale at all the participating hospitals through June 3, thereafter at the gate. Use your Mastercard or Visa Card, by calling (212) 808-8100, Monday through Friday, 9 a.m. - 5 p.m.

Spectators are urged to arrive early and be among the first 1500 each day to receive a free visor at the gate. **Make it a point to stop by the Expo '88 tent behind the 18th green for exciting exhibits and dining.**

Benefiting Hospitals: United, Lawrence Auxiliary, New Rochelle, Northern Westchester, Phelps Memorial, St. Agnes, St. John's, St. Joseph's, St. Vincent's, Blythedale Children's, Greenwich, Mount Vernon, White Plains, Yonkers General, Peekskill and Putnam Hospital Center.

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